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# Supreme Court of the United States

OCTOBER TERM, 1944.

No. 414.

CONSOLIDATED REALTY CORPORATION, REALTY ASSOCIATES SECURITIES CORPORATION, Debtor, and AMALGAMATED PROPERTIES, INC.,

*Petitioners,*

*v.*

EDWIN B. MEREDITH, JACOB R. SCHIFF, and MILTON C. ZAIDENBERG, constituting the Bondholders' Protective Committee; JOHN VANNECK, BARBARA B. VANNECK, EQUITABLE HOLDING CORPORATION, VANNECK REALTY CORPORATION and FRANK BAILEY; ANNA KUHLMANN and CATHERINE KUHLMANN, *et al.*,

*Respondents.*

## REPLY BRIEF OF PETITIONERS IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

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JAMES F. DEALY,
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Petitioners,

v.

EDWIN B. MEREDITH, JACOB R. SCHIFF, and MILTON C. ZAIDENBERG, constituting the Bondholders' Protective Committee; JOHN VANNECK, BARBARA B. VANNECK, EQUITABLE HOLDING CORPORATION, VANNECK REALTY CORPORATION and FRANK BAILEY; ANNA KUHLMANN and CATHERINE KUHLMANN, et al.,

Respondents.

## REPLY BRIEF OF PETITIONERS IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

This brief is submitted by petitioners, Consolidated Realty Corporation, Realty Associates Securities Corporation, Debtor, and Amalgamated Properties, Inc., in reply to the memorandum filed by the Securities and Exchange Commission (hereinafter referred to as the "SEC") and the brief in opposition filed by respondents. Except for a jurisdictional point in the latter brief, both address themselves to the merits of the result rather than to the merits of the decision below or to the question of whether the writ

should be granted. The petition raises only the question whether the Court below was required as a matter of law to disqualify the Additional Trustee by virtue of Section 158. The SEC memorandum, particularly, reargues points which did not prevail in the Court below and which are not raised by the petition.

## I.

### In Reply to the SEC Memorandum and Point I of Respondents' Brief.

The SEC and respondents attempt to apply to the Additional Trustee rules which were developed for entirely different situations. They state that the courts at an early date established the rule that a trustee in bankruptcy or an equity receiver could not have any interest in, or with respect to, a debtor.[1] But it was soon recognized, where the business was to be continued pending reorganization, that the operation of the business could not be turned over to strangers, and that the knowledge and experience of the former management were essential.[2] Accordingly, it became a common practice in equity receivership reorganizations to appoint co-receivers—one selected from the management and another having no prior connection with the debtor.[3]

This practice culminated in the enactment of Section 77B, where the debtor itself could be, and in most cases was, left in possession to act in all aspects of the reorganization.[4] This procedure was found to be desirable

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[1] SEC Memorandum, pp. 11-12; Respondents' Brief, p. 8.

[2] Finletter, *Principles of Corporate Reorganization*, pp. 190, 193-194.

[3] Gerdes, *Corporate Reorganizations: Changes Effected by Chapter X of the Bankruptcy Act* (1938) 52 Harv. L. Rev. 1, 10.

[4] 11 U. S. C. A. §207(c); H. R. Rep. No. 1409, 75th Cong. 1st Sess. (1937) 37.

in many cases since reorganization proceeded more expeditiously and the going concern value was better preserved, but in some cases it opened the door to fraud and oppression. It permitted the debtor (in effect the management) to conduct the investigation into the desirability of continuing the business, competence of the management and possible causes of action against the officers and directors, and to prepare the plan of reorganization.

Because of these defects which, in a few cases, permitted an incompetent, or even dishonest, management to continue itself in office or force through a plan of reorganization not in the best interests of all parties, the SEC and the Committee on the Judiciary of the House of Representatives recommended a provision requiring the appointment of only disinterested trustees in every reorganization where the liabilities exceeded $250,000[5] This proposal was passed by the House as part of the Chandler Bill (H. R. 8046), but raised such a protest at the Congressional hearings that the Senate Committee amended the Bill to keep the best features of both the Chandler Bill and 77B.[6] Investigation of the conduct of the business and preparation of the plan of reorganization were left exclusively to the disinterested trustee,[7] but, for the operation of the business, a new position was created which was totally unprecedented and, for lack of a better title, was designated as the Additional Trustee. This officer was denied any

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[5] SEC, *Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees*, Part I, p. 899; H. R. Rep. No. 1409, 75th Cong., 1st Sess. (1937) 42-43.

[6] Hearings before a Sub-Committee of the Senate Committee on the Judiciary on H. R. 8046, 75th Cong., 2nd Sess. (1937-1938) 20, 29-30, 103, 200-201; Sen. Rep. No. 1916, 75th Cong., 3rd Sess. (1938) 27-28; see also Hearings before the House Committee on the Judiciary on H. R. 6439 and H. R. 8046, 75th Cong., 1st Sess. (1937) 290, 327-328, 343, 367-370.

[7] Sections 156, 167, 169.

function in the reorganization, except to assist the disinterested trustee in the operation of the business.[8] Thus, the long conflict was resolved. The debtor would be permitted to suggest to the Court a man familiar with its affairs to assist the disinterested trustee in the operation of its business, thereby preserving the assets and the going concern value for the creditors and stockholders, but any such person would be completely divorced from all other aspects of the reorganization. Thus, the Bill, as finally enacted, fully met the basic requirements of the SEC and the House Committee by vesting exclusively in disinterested trustees the investigation of the business and the desirability of the continuance thereof, the preparation of a plan of reorganization and reports to the Court thereon.

Under Chapter X, more stringent rules of disinterest are imposed on the trustee having general control over the reorganization than were imposed in bankruptcy, equity receiverships or 77B. On the other hand, Congress did not impose any limitations on the qualifications of the Additional Trustee, except to require that he *must* be a director, officer or employee. Indeed there was no reason to impose any further restriction since the Additional Trustee acts only in a limited capacity. Congress has now specifically required that the Additional Trustee be selected from the class of persons having the type of interest most likely to be adverse to creditors and which would automatically disqualify them from acting as trustees in straight bankruptcy. It is implicit in this basic change that Section 158 and the rules of disqualification applicable to trustees in straight bankruptcy or equity receivers do not apply to the Additional Trustee.

The Court below recognized this to the extent of conceding that the disqualification of stockholders in Section

[8] Sections 156, 189. See also Fifth Annual Report of SEC, p. 12.

158(1) would be inapplicable (R. 376). The Court's reason was that it is a common occurrence for a director or officer to be a stockholder. But it is also common, in cases involving large corporations with liabilities in excess of $250,000, for directors and officers to be creditors or bondholders of the debtor or directors of corporations dealing with the debtor. The only proper conclusion is that under Chapter X no part of Section 158 or the general rules of disqualification of trustees is applicable to the Additional Trustee. Of course, the Additional Trustee must be a person of integrity having the ability required to discharge the duties imposed upon him. Nothing more is necessary since he acts solely in the operation of the business in conjunction with the disinterested trustee and under the supervision of the Court. The exercise of such supervision is within the sound discretion of the Court. In this case, for example, the District Judge has established a procedure to eliminate the possibility of any harm to the creditors, which is in line with the view expressed by Judge Learned Hand (Pet. 6, 16).

There is no warrant for a construction of Sections 156 and 158 of Chapter X which, on the one hand, would permit an Additional Trustee to have the basic conflicts inherent in the appointment of a director, officer, employee, stockholder or creditor, any of which would disqualify a bankruptcy trustee, and, on the other hand, would disqualify the Additional Trustee because of his connection with other corporations which are likely to have business dealings with the Debtor.

## II.

### In Reply to Point II of Respondents' Brief.

The District Judge has found that the Additional Trustee's "advice, assistance and direction were very essential to the management of the business and that his continuance may be regarded as a necessity * * * [and] to a large degree indispensable" (R. 353-354). It is disingenuous to argue, in the face of this finding, that the reversal by the Court below of the Additional Trustee's appointment strictly on a point of law does not injure the petitioners who are the stockholder of the solvent Debtor, the Debtor itself, and a large bondholder of the Debtor (Pet. 1-2, 4).

The findings of the District Court are amply supported by the evidence (Pet. 4-5). Other bondholders and the Indenture Trustee, who filed briefs in the Court below in opposition to the removal of the Additional Trustee, agreed that the best interests of the estate required his continuance in office. The Court below did not question the findings of the District Court and, over the opposition of respondents, granted a stay of the issuance of its mandate pending final disposition by this Court of the legal point involved.

The questions whether an Additional Trustee can himself appeal and what would happen if the District Court should remove him at will under Section 160 of the Bankruptcy Act are totally irrelevant. In this case, the District Court found that the Additional Trustee was essential and refused to remove him; the Court below reversed, not as a matter of discretion but only on the ground that Section 158 constituted an absolute disqualification; and the petition for

a writ of certiorari has been made by three parties having a substantial interest in the reorganization.[9]

Section 24 of the Bankruptcy Act, which is set forth in the Appendix hereto, makes it clear that, after a finding that the services of the Additional Trustee are essential, a judgment of the Circuit Court reversing, on legal grounds, orders retaining him in office is subject to review in this Court on application by any party in interest.

Respectfully submitted,

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JOHN D. GOODLOE,
General Counsel, Reconstruction Finance Corporation, the holder of all of the capital stock of Petitioner Consolidated Realty Corporation.

I have authorized the filing of this brief.

CHARLES FAHY,
Solicitor General.

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[9] Appeals from orders refusing to appoint a Trustee have been entertained in the following cases: *In re Philadelphia & Reading Coal & Iron Co.*, 104 F. (2d) 126 (C. C. A. 3rd, 1939) (Order denying motion in 77B proceeding pending at the time of the enactment of Chapter X to compel the appointment of a Trustee under Section 156 of Chapter X); *In re Philadelphia & Reading Coal & Iron Co.*, 105 F. (2d) 354 (C. C. A. 3rd, 1939) (Order denying motion to proceed with hearing on application for appointment of Trustee); see *Lansdown* v. *Faris*, 66 F. (2d) 939, 940 (C. C. A. 8th, 1933) (Railroad reorganization under Section 77 of the Bankruptcy Act).